

INTERNAL REVENUE SERVICE

Midstates Region

Department of the Treasury

Appeals Office

Date: APR 23 1996

Person to Contact:

Telephone Number:

Key District:

Years:

Dear Sir:

We considered your appeal of the adverse action proposed by your key District Director. Your exemption from Federal income tax under Section 501(c)(4) of the Internal Revenue Code is denied.

Your denial is based primarily on the fact that your organization primarily serves the private interests of your members by maintaining their property. Any benefits to the community are not sufficient to meet the requirement that an organization described in section 501(c)(4) of the Code be operated primarily for the common good and general welfare of the people of the community.

You are required to file Federal income tax returns on Form 1120 for the above years. You should file these returns with your District Director, Dallas Key District Office, EP/EO Division, within 60 days from the date of this letter, unless a request for extension of time is granted.

You may direct questions about the decision to the appeals officer whose name and telephone number are shown above.

Sincerely,

Associate Chief, Appeals

cc:

Internal Revenue Service

Department of the Treasury

District
Director

Date: JUN 28 1994

Person to Contact:

Telephone Number:

Refer Reply To:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(04) of the Internal Revenue Code.

You incorporated as a non-profit corporation in the State of [REDACTED] on [REDACTED] for the purposes of providing for the welfare and benefit of the owners, residents, and occupants of the land comprising "[REDACTED]"; promoting the recreation, health, safety, and welfare, of members of the Association and land within [REDACTED]; and maintaining property values of [REDACTED].

Currently, the developer is advancing all monies necessary for your operations. The advances will continue until annual assessments commence. According to the Declaration of Covenants, Conditions and Restrictions for [REDACTED], these assessments will commence on the date notice is given to each owner that construction and landscaping of an easement adjacent to [REDACTED] has been completed.

Per your Articles of Incorporation, membership belongs to every person or entity who is a record owner of fee simple title to any land that is subject to the Declaration. Votes shall be assigned on the basis of voting unit which shall be one square foot of land area within each fee parcel of land subject to the Declaration. Of [REDACTED] voting units, the developer controls [REDACTED] or [REDACTED] %.

Your governing board is elected by your members and since the developer has voting control, the developer has control of the board.

COF

[REDACTED]

When asked to provide demographics for your area, you indicated you are in close proximity to several other associations that together all make up the [REDACTED] area. That area's demographics include neighborhoods of single family residences located close to the general area, [REDACTED] apartment complexes, [REDACTED] major corporations, [REDACTED] hotels, restaurants, retail businesses, day care center and banks. Upon further inquiry, you admitted there was only a [REDACTED] and public school in the area and that your membership was composed of [REDACTED] members including those previously mentioned, the developer, and an oil company who is proposing to build a service station in the area.

You have contracts with [REDACTED] different companies for management and contracts for landscaping which account for most of the expenses you have accrued to date to be paid to the developer. The total accrued is over \$[REDACTED]. To date most of the landscaping has been along [REDACTED] on property owned by the State. The property is adjacent to your area.

You could not account for some expenses and later indicated they were the result of audit error.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

"(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Section 1.501(c)(4)-1 of the regulations provides, in part, as follows:

"(a)(1) In general. A civic league or organization may be exempt as an organization described in section 501(c)(4) if -

- (i) It is not organized or operated for profit; and
- (ii) It is operated exclusively for the promotion of social welfare."

████████████████████

"(a)(2)(i) An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements *** The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.***"

Revenue Ruling 72-102, 1972-1 C.B. 149, granted exemption under section 501(c)(4) of the Code to an organization formed to preserve the appearance of a housing development and to maintain streets, sidewalks, and common areas for use of the residents. It was supported by annual assessments and member contributions. Even though it was established by the developer and its existence may have aided him in selling housing units, any benefits to the developer were merely incidental.

Revenue Ruling 74-99, 1974-1 C.B. 131, indicates for a homeowners association to qualify for exemption under section 501(c)(4) of the Code it (1) must serve a "community" which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) must not conduct activities directed to the exterior maintenance of private residences, and (3) must have the common areas or facilities it owns and maintains for the use and enjoyment of the general public.

Revenue Ruling 80-63, 1980-1 C.B. 116, clarified the reference to "community" in Revenue Ruling 74-99 by indicating that the area represented by an association may not be a community within the meaning of that ruling, but may still qualify for exemption if its activities serve the general public as distinguished to serving members only.

You do not meet the definition of the term community as defined in Revenue Ruling 74-99 based on development to date. Your substantial activity has been in maintaining property that belongs to the State, not the association. The maintaining of that property does serve the general public and would seem to meet the requirements of Revenue Ruling 80-63. However, since you are

[REDACTED]

controlled by the developer the activity is basically an activity of the developer and lacks the membership normally associated with a homeowners association. It allows the developer to beautify an area adjacent to his development to enhance sales opportunity while accruing the cost to future association members rather than expensing the costs as incurred and having the developer assume his share of the costs. Since the association has existed since [REDACTED] with minimal development the benefit of beautifying the adjacent area to encourage interest substantially serves the developer. There is also a question as to whether [REDACTED] management contracts were needed for such limited activity, or whether the contracts serve the developer by providing business to organizations the developer does business with, thus promoting his continued relationship with them.

Thus, we conclude that you are not operated exclusively for the promotion of social welfare and serve private interests of the developer. Therefore, you do not qualify for exemption under section 501(c)(4) of the Code. Accordingly you are not exempt and should file Form 1120.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law, and argument that clearly sets forth your position. If you desire an oral discussion of the issues, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

We have sent a copy of this letter to your representative as indicated in your power of attorney.

If you have any further questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

[REDACTED]
District Director

Enclosures:
Publication 892
Form 6018